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84-871

NO.

In the Supreme Court of the United States

October Term, 1984

LOUISIANA PUBLIC SERVICE COMMISSION,

Appellant

versus

FEDERAL COMMUNICATIONS COMMISSION and UNITED STATES OF AMERICA,

Appellees

On Appeal from the United States Court of Appeals for the Fourth Circuit

APPENDIX TO JURISDICTIONAL STATEMENT VOL. II—APPENDIX A (Continued) — APPENDIX E

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BEFORE THE

FEDERAL COMMUNICATIONS COMMISSION

WASHINGTON, D.C. 20554

CC Docket 79-105

In the Matter of

Amendment of Part 31, Uniform System of Accounts for Class A and Class B Telephone Companies, of the Commission's Rules and Regulations with respect to accounting for station connections, optional payment plan revenues and related capital costs, customer provided equipment and sale of terminal equipment.

MEMORANDUM OPINION AND ORDER

Adopted: April 1, 1982; Released: April 27, 1982

BY THE COMMISSION: COMMISSIONERS FOGARTY AND JONES DISSENTING AND ISSUING A JOINT STATEMENT; COMMISSIONER RIVERA DISSENTING.

1. We have before us a petition for clarification of our *First Report and Order* in this proceeding (85 FCC 2d 818 (1981)) filed by the National Association of Regulatory Utility Commissioners (NARUC) and a petition for reconsideration of that *Report and Order* filed by the People of the State of California and the Public Utilities Commission of the State of California (California). The *First Report and Order,* commonly known as "Expensing of Station Connections," adopted a number of changes in Part 31 of this Commission's Rules (Uniform System of Accounts for Class A and Class B Telephone Companies). The principal

changes required that future costs of installing new inside wiring and similar costs be included as an expense in Account 605 (Repair of Station Equipment). Such costs have previously been capitalized in Account 232 (Station Connections). The *First Report and Order* also required that the present net investment in inside wiring and investment that will be added during a transition period be amortized over a period of 10 years. That requirement superseded existing depreciation prescriptions for such investment.

2. Both petitions raise the question of whether, and to what extent, the adoption of the *First Report and Order* limits the discretion of state commissions to follow different accounting and depreciation procedures for purposes of computing revenue requirements for intrastate telecommunications services. NARUC seeks a clarification of the *First Report and Order* declaring that it does not restrict the discretion of the state commissions and California seeks reconsideration of our decision to the extent that it purports to restrict the discretion of state commissions. GTE Service Corporation (GTE) and American Telephone and Telegraph Company (AT&T) have filed oppositions to the petitions. Those companies contend that the *First Report and Order* does and should restrict the discretion of the state commissions.

3. We have concluded that the *First Report and Order* does not preclude state commissions from using other accounting or depreciation procedures for intrastate ratemaking proceedings. Thus, we are granting the NARUC petition insofar as it seeks such a clarification. In view of our conclusion that state commissions are not precluded from using their own accounting and depreciation procedures for intrastate ratemaking purpose, it is unnecessary to consider further the California petition and it will be dismissed as moot.

I. Nature of the First Report and Order

4. In our Phase II *Final Decision and Order* in Docket 19129, 64 FCC 2d, 1, 54-56 (1977), we concluded that it would be desirable to place costs associated with station connections on the causative ratepayer. We accordingly ordered AT&T to submit a plan for changing the accounting treatment of station connection costs that would be consistent with that objective. *Id.* at 110. AT&T responded by filling a petition for rulemaking (RM-3017) that proposed amendments to Part 31 of our Rules. After reviewing that petition, we instituted this proceeding by inviting comments upon a somewhat different proposal to modify accounting for station connections.[1]

5. After reviewing the comments, we concluded that any changes in the accounting or other regulatory treatment of station connections should not include drop or block lines and protectors. We also concluded that changes in accounting procedures would not be sufficient in and of themselves to place other station connection costs on the causative ratepayer. This is the case because costs associated with the provision of inside wiring necessarily must be apportioned between the federal and state jurisdictions as long as inside wiring is provided as a tariffed service subject to dual regulation. Complete unbundling cannot be achieved by expensing rather than capitalizing such costs because both the telephone operations investment and telephone operations expenses are apportioned for purposes of computing an interstate and an intrastate telecommunication service revenue requirement. Complete

[1] Notice of Proposed Rulemaking (CC Docket 79-105), 44 F.R. 48988 (August 14, 1979). We also invited comment upon some other proposed accounting changes that are closely related to station connections.

unbundling could be achieved by determining that the provision of inside wiring should be provided on a detariffed basis. We have, of course, made such a determination with respect to customer premises equipment and have adopted rules to separate that business from the telephone operations that are subject to tariff regulation.[2] We concluded that it would be premature to adopt such a fundamental change in the regulatory status of inside wiring without conducting further inquiry.

6. Nevertheless, we concluded that changes in accounting and depreciation procedures that would facilitate implementation of any decision to change the regulatory status of inside wiring would be desirable in the absence of such a change. We accordingly issued a *First Report and Order* adopting changes in accounting and depreciation rules and a separate *Further Notice of Inquiry* (86 FCC 2d 885 (1981)) inviting additional comments with respect to possible changes in the regulatory status of inside wiring. The *First Report and Order* does not produce any change in regulatory status. The interstate portion of the embedded net investment will be reflected in the return component of the interstate telecommunication service revenue requirement and the interstate portion of the annual amortization and the new installation expenses will be reflected in the expense component of that revenue requirement. Unless and until we determine that inside wiring should not be provided as part of a tariffed service, the new accounting rules will not have a greater or different effect than any other accounting rules we have prescribed for the

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[2] See *Primary Instrument Concept (PIC)*, 68 FCC 2d 1157 (1978); *Second Computer Inquiry Final Decision*, 77 FCC 2d 384 (1980), *recon.*, 84 FCC 2d 50 (1980); *further recon.*, (FCC 81-481, released October 30, 1981).

purpose of computing the interstate telecommunication service revenue requirement.

7. Insofar as the petitions seek a determination with respect to this Commission's purpose and intent, we conclude that the *First Report and Order* was not intended to have any preemptive effect that does not arise by operation of law. The discussion of the effects of expensing upon intrastate rates and revenue requirements in that Order was based upon the assumption that all or most state commissions would choose to follow those rules for purposes of computing intrastate telecommunications service rates. Our decision to permit carriers to accelerate the transition to expensing with the approval of state regulatory commissions was also based on the assumption that few, if any, of the state commissions would choose to prohibit expensing for intrastate ratemaking purposes. Such assumptions appeared reasonable because most state commissions have followed most accounting and depreciation procedures prescribed by this Commission in the past and the considerations that led us to conclude that expensing will benefit both carriers and consumers in the long run are equally applicable to intrastate ratemaking. No policy of this Commission would be furthered by requiring state commissions to adhere to the rules we have adopted for purposes of computing the interstate revenue requirement. If carriers adhere to our rules for purposes of computing the interstate revenue requirement, our purpose will be achieved.

8. The participants in this proceeding may not view the preemption issue as a question of intent, but rather as a matter of statutory interpretation. The petitioners may be contending that this Commission could not require state commissions to follow our accounting or depreciation rules

for intrastate ratemaking purposes and AT&T and GTE apparently contend that Section 220 of the Communications Act precludes state commissions from departing from any accounting or depreciation rule that has been prescribed by this Commission. To the extent this is the case, this controversy might more appropriately be characterized as a request for a declaratory ruling with respect to the meaning and effect of Section 220 that is not limited to these particular rules. We do not propose to deny relief because the petitions or oppositions may not be properly labeled. We have concluded, for reasons explained in Part II, that Section 220 does not preclude state commissions from departing from accounting or depreciation rules prescribed by this Commission for purposes of regulating intrastate telecommunication service rates.

II. Effect of Section 220

9. AT&T and GTE rely primarily upon Subsection 220(g) to support their contention that Section 220 precludes the states from departing from our accounting and depreciation rules for purposes of computing intrastate telecommunication service revenue requirements. Subsection (g) provides:

> (g) After the Commission has prescribed the forms and manner of keeping of accounts, records, and memoranda to be kept by any person as herein provided, it *shall be unlawful for such person to keep any other accounts, records or memoranda than those so prescribed* or such as may be approved by the Commission or to keep the accounts in any other manner than that prescribed or approved by the Commission. Notice of alterations by the Commission in the required manner or form of keeping accounts shall

be given to such persons by the Commission at least six months before the same are to take effect. (Emphasis added)

10. Subsection (g) does not literally impose any restriction upon the power of the states to regulate intrastate rates or the methods state commissions use to determine whether a particular rate will be approved or prescribed. A state commission could theoretically adjust information derived from a carrier's system of accounts for purposes of its own ratemaking without creating any conflict with obligations that Subsection (g) imposes upon carriers. Nevertheless, it would be extremely difficult as a practical matter for a state commission to perform such ratemaking computations without requiring a carrier to collect and compile some data in some form that might be described as "accounts, records or memoranda." Thus, AT&T and GTE may be contending that Subsection (g) implicitly precludes the use of other accounting methods or systems for other regulatory purposes when this Commission has prescribed methods that must be used for interstate ratemaking purposes.

11. Subsections (a)-(g) of Section 220 were in the main a reprint of provisions contained in Section 20 of the Interstate Commerce Act.[3] Although the Interstate Commerce Act was designed for the regulation of railroads, many of the provisions were extended to communications common carriers and the Interstate Commerce Commission was in the process of developing accounting and

[3] At the time of adoption of Section 220(g) of the 1934 Communications Act, Section 20(5) of the Interstate Commerce Act provided that "...it shall be unlawful for such carriers to keep any other accounts, records, or memoranda than those prescribed by the Commission..." 41 Stat. 493 (1920). See 49 U.S.C. § 20(5).

depreciation rules for telephone companies at the time the Communications Act was adopted. In the absence of statutory changes or indications to the contrary, it is assumed that whenever the legislature enacts or reenacts a provision in an existing statute it has in mind the previous statute relating to the same subject matter.[4] Unless the context indicates otherwise, words and phrases in a provision that were used in a prior act pertaining to the same subject matter will be construed to be used in the same sense.[5]

12. The parallel section 20 language was added to the Interstate Commerce Act by the Hepburn Act of 1906, 34 Stat. 584. The legislative history of the Hepburn Act does not shed any light upon Congressional reasons for prohibiting railroads from maintaining accounts, records or memoranda other than those prescribed by the ICC. Congress may have wished to inhibit the railroads from defrauding investors through fraudulent or sloppy accounting practices or to prevent the railroads from concealing unlawful rebates. There is no indication in the legislative history of the Hepburn Act that the 1906 Congress wished to curb state regulation of railroads. The Act was apparently motivated solely by a desire to make railroad regulation more effective.

13. ICC accounting rules that were promulgated pursuant to Section 20 of the Interstate Commerce Act were challenged in *Int. Com. Commission v. Goodrich Trans. Co.*,

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[4] Courts have attached great weight to interpretations of Interstate Commerce Act provisions in interpreting the Communications Act. See e.g., *American Telephone and Telegraph Company v. F.C.C.*, 487 F.2d 864, 873-874 (2d Cir. 1973).

[5] See Sutherland, *Statutory Construction*, Section 51.02 (C. Sands ed. 1972) and cases cited therein.

224 U.S. 194 (1912) (hereinafter cited as *Goodrich*). The railroad contended that the ICC had exceeded its authority by prescribing the form of accounts for activities that were not subject to ICC rate regulation. The Supreme Court sustained the ICC accounting rules on the theory that the ICC needed information about such activities in order to regulate the activities that were subject to ICC rate regulation. The Court said (*id.* at 211):

> If the Commission is to successfully perform its duties in respect to reasonable rates, undue discriminations and favoritism, it must be informed as to the business of the carriers by a system of accounting which will not permit the possible concealment of forbidden practices in accounts which it is not permitted to see and concerning which it can require no information. It is a mistake to suppose that the requiring of information concerning the business methods of such corporations, as shown in their accounts, is a regulation of business not within the jurisdiction of the Commission, as seems to be argued for the complainants. The object of requiring such accounts to be kept in a uniform way and to be open to the inspection of the Commission is not to enable it to regulate the affairs of the corporations not within its jurisdiction, but to be informed concerning the business methods of the corporations subject to the act that it may properly regulate such matters as are really within its jursidiction.

14. *Goodrich* is of limited relevance because that case did not raise any question with respect to the effect of ICC accounting rules upon the regulation of activities that were not subject to ICC rate regulation. Nevertheless, a construction of Section 20 that would have limited the states' discretion to regulate intrastate rail rates would have been

inconsistent with the Court's description of the nature and function of the accounting rules.

15. The adoption of an interpretation of Section 20(5) of the Interstate Commerce Act or Section 220(g) of the Commerce Act that restricts state accounting practices for purposes of intrastate ratemaking would also restrict other forms of state or federal regulation that might require accounting records or information that differ from data generated by the rules prescribed for interstate ratemaking. Indeed such an interpretation would appear to preclude carriers from using accelerated depreciation methods for purposes of computing their income taxes since such methods differ from the depreciation methods that have been prescribed for ratemaking purposes.

16. The question of the effect of ICC accounting requirements upon railroad tax accounting did arise before the Communications Act was enacted. The Interstate Commerce Commission had required a railroad to amortize the value of certain abandoned property over a period of 15 years and to charge the amortized amounts as an operating expense for accounting purposes. The railroad contended in *Kansas City Southern Ry. Co. v. Commissioner of Int. Rev.*, 52 F.2d 372 (8th Cir. 1931) that the Commissioner was required to accept the amortized expenses as a deduction from income because failure to do so would violate Section 20 of the Interstate Commerce Act. The Court summarily rejected that contention.

The Court said (*Id.* at 378):

> The Commission did not purport in requiring the loss for abandonment to be charged to operating expenses to provide any standards for tax

> authorities to follow. This would be beyond its province....Systems of accounting for railroads under the control of the Commission cannot interfere with the government's system of taxation. The Commission has not power to direct how the Revenue Laws of the United States shall be interpreted or by its orders provide standards to govern the taxing authorities.

17. AT&T apparently contends that providing standards for state-regulators to follow was within the Interstate Commerce Commission's province and that the ICC had specifically rejected contentions that Section 20 of the Interstate Commerce Act did not give it that power. AT&T's reliance on *Depreciaton Charges of Telephone Companies,* 118 I.C.C. 295 (1926), is misplaced. In the *Depreciation Charge* proceeding, NARUC had argued that the words "as soon as practicable" contained in section 20(5) gave the ICC latitude to refrain from prescribing depreciation requirements for the local telephone companies engaged only to an insignificant extent in interstate commerce. In rejecting NARUC's position, the ICC merely held that its obligation under Section 20(5) to prescribe depreciation rates for telephone companies was mandatory, not discretionary.[6] In dicta, the Commission additionally appeared to suggest that its authority under Section 20(5) extended to all property "open for use in interstate commerce." Petitioners in CC Docket No. 79-105, however, do not appear to dispute the authority of the FCC, under section 220 of the Communications Act, to extend its accounting and depreciation prescriptions to cover assets used for primarily intrastate purposes. The ICC's 1926 telephone depreciation charge proceeding is silent on the issue of whether federal prescription of depreciation rates preempts

[6] 118 I.C.C. at 332-33.

the states from prescribing additional and distinct depreciation rates and classifications covering the same property for regulatory purposes.[7]

18. AT&T further cites *Accounting Rules For Telephone Companies*, 203 ICC 13 (1934), in support of its contention that state commissions lack jurisdiction over telephone company accounts insofar as intrastate service is concerned. Here, again, we disagree with AT&T's reading of this opinion. In *Accounting Rules For Telephone Companies* (an advisory opinion for the benefit of the newly created Federal Communications Commission) the ICC concluded, over the objections of the states, only that the federally-prescribed system of accounts should be uniform in its treatment of telephone companies operating among the several states.[8] Indeed, far from preempting the states from independently prescribing separate additional accounts, the ICC expressly recognized that the states might have additional accounting needs and sought to assist the states in this respect by permitting state-prescribed sub-accounts within the federally-required books of account. The ICC stated;

> In the measures adopted with respect to the uniform system, we are acting in pursuance of the direction of Congress. Uniformity is the desired and important object. The nature of the undertaking necessarily precludes the incorporation of special provisions covering the requirements of the several State commissions.

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[7] Indeed, the Supreme Court has placed this same construction on the ICC's order in the *Depreciation Charge* proceeding. *Smith v. Illinois Bell Tel. Co.*, 282 U.S. 133, 159 (1930).

[8] See also, *Kansas City So. Ry. v. United States*, 231 U.S. 423 (1913); and *Int. Com. Comm. v. Goodrich Trans Co., supra.*

> We have, however, recognized the needs of the several State commissions in the intrastate regulation which is their duty and have, endeavored to help them in the securing of all necessary information by leaving it open to them to require subdivision of the accounts prescribed.

Since the ICC may not delegate any of its authority under the Interstate Commerce Act to the individual states,[9] ICC acceptance of these state prescribed sub-accounts may be construed as recognition of the power of the states to require accounts for this own regulatory purposes independent of the scope of the Commission's authority to prescribe accounts for federal purposes.[10]

19. That Commission's conclusion that states may supplement a uniform system would not preclude a conclusion that Section 20 of the Interstate Commerce Act or Section 220 of the Communications Act forecloses states from departing from a federally prescribed accounting system by adopting accounting methods that are inconsistent with the federal system. That ICC opinion does contain language that indicates that the ICC believed such departures from uniformity would be undesirable, but the ICC did not conclude that such departures are precluded by statute.

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[9] See, 49 U.S.C.A. Section 17(2); and Davis, *Administrative Law Treatise*, Ch. 3 (1978).

[10] Significantly, the FCC also has permittted state-prescribed sub-accounts in the USOA books, 47 C.F.R. Section 31.10-2(f) provides the following:

> Nothing contained in the part shall prohibit or excuse any carrier or receiver or operating trustee of any carrier from subdividing the accounts hereby prescribed *in the manner ordered by any State commission having jurisdiction* or to the extent necessary to secure the information required in the prescribed reports to such commission. (Emphasis added.)

20. Supreme Court decisions relating to Section 20 of the Interstate Commerce Act never squarely addressed the question of the extent of the states' power to prescribe accounting and depreciation rules that supplement or deviate from rules prescribed by the ICC. A telephone company did challenge certain state-prescribed depreciation requirements in *N. W. Bell Tel. Co. v. Ry. Comm'n*, 297 U.S. 471 (1936). The Court concluded that Section 20 clearly did not preclude a state commission from adopting and enforcing depreciation rules prior to the adoption of the ICC depreciation rules. The Court expressly declined to determine what effect the adoption of ICC depreciation rules would have upon the state commission's powers.

21. Inasmuch as Section 20 had never been construed to restrict state commissions from requiring carriers to keep additional records for purposes of intrastate ratemaking and court decisions in analogous contexts did not adopt an expansive interpretation of that provision, the reenactment of that language should not be interpreted to restrict state commissions from keeping such additional records in the absence of clear evidence that the 1934 Congress intended to produce that result. AT&T and GTE would infer such an intent from that Congress failure to enact a proposed subsection 220(j) that would have provided:

> Nothing in this section shall (1) limit the power of a State commission to prescribe, for the purposes of the exercise of its jurisdiction with respect to any carrier, the percentage rate of depreciation to be charged to any class of property of such carrier, or the composite depreciation rate, for the purpose of determining charges, accounts, records or practices;
>
> (2) relieve any carrier from keeping any accounts, records, or memoranda which may be required to

> be kept by any State commission in pursuance of authority granted under State Law.[11]

22. This version of section 220(j) passed the House but was eliminated from the Senate bill. The revised Senate version of Section 220(j) provided instead:

> The Commission shall investigate and report to the Congress whether in its opinion legislation is desirable (1) authorizing the Commission to except the carriers of any particular class or classes in any State from any of the requirements under this section in cases where such carriers are subject to State commission regulation with respect to matters to which this section relates; and (2) permitting the State commissions, in pursuance of authority granted under State Law, to prescribe their own percentage rates of depreciation or systems of accounts, records, or memoranda to be kept by carriers.[12]

23. The Conference Committee drafted a compromise that retained the House version of subsection 220(h) and substituted a new subsection 220(j) for both the House and Senate versions. The Conference Committee version of Section 220, which was enacted without further modification, also included a subsection (i) that did not parallel Interstate Commerce Act language. Subsections (h)-(j) provided:

> (h) The Commission may classify carrier subject to this Act and prescribe different requirements under this section for different classes of carriers, and may, if it deems such action consistent with

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[11] S. 2910, 73d Cong., 2d Sess. Section 220(j) (February 20, 1934); H.R. 8301, 73d Cong., 2d Sess. Section 220(j) (February 27, 1934).

[12] S. 3285, 73d Cong., 2d Sess. Section 220(j) (March 28, 1934).

the public interest, *except the carriers of any particular class or classes in any state from any of the requirements under this section in cases where such carriers are subject to State commission regulation with respect to matters to which this section relates.* (Emphasis added)

(i) The Commission, before prescribing any requirements as to accounts, records, or memoranda, shall notify each State commission having jurisdiction with respect to any carrier involved, and shall give reasonable opportunity to each such commission to present its views and recommendations.

(j) The Commission shall investigate and report to Congress as to the need for legislation to define further or harmonize the powers of the Commission and of State commissions with respect to matters to which this section relates.

24. AT&T and GTE argue that statements by witnesses at the committee hearings both in favor of and in opposition of the original version of Section 220(j) support the position that Congress intended in dropping this provision to preempt the states for all purposes. They contend that statements by witnesses from both sides were premised on the belief that absent a provision similar to original section 220(j) the states would be bound by federal accounting and depreciation prescriptions in their local regulation. We disagree.

25. The record of the Congressional hearings indicates little more than that the supporters of original section 220(j) believed that the provision was desirable to resolve a previous unsettled point of law under the predecessor provision of the Interstate Commerce Act.

This desire on the part of the state commissions to have Congress explicitly recognize the authority of the states to prescribe accounts and depreciation rates for local regulatory purposes is reflected in the following statements of J. E. Benton, NARUC's general solicitor (emphasis added).

> Section 220, which is the section giving the Commission jurisdiction to prescribe accounts and reports, also takes account of local conditions and safeguards the powers of State commissions in the matters of depreciation and of accounting regulations. *The State commissions are very solicitous that the act shall be so phrased that it cannot be construed* as imposing any depreciation regulation promulgated by the Federal Commission upon the regulatory agencies of the States.
>
> * * * * * * *
>
> Ever since the power to fix depreciation rates was given to the Interstate Commerce Commission in 1920, *the State commissions have been apprehensive that when an order finally came to be fixed by a Federal Commission it would be pointed to by the utilities as depriving the State commissions thereafter of going into the question of depreciation in rate cases...*
>
> * * * * * * *
>
> [W]e do not ask for any particular form of words, but there should go into the act a provision which makes it clear that in the administration of their laws for the regulation of rates, the State commissions shall have the power in rate cases to determine what allowances shall be made for depreciation in the rates which are fixed.
>
> [T]he State Commissions believe that it is not in the public interest that the act shall contain a

> mandate to the Federal commission to fix rates of depreciaton unles *it shall be made entirely clear* in the act that such determination is for the use of the Federal commission only and is not to affect the State commissions in their regulatory work.
>
> * * * * * * *
>
> That section merely proposes to provide, in plain terms, that the control of intrastate telephone business as now exercised by the States, shall continue to be exercised by them without interference by the Federal Commission.[13]

26. Several witnesses opposed original section 220(j) on the grounds that it would create the possibility of unreasonably burdening the carriers with the cost of multiple sets of books,[14] that it would destroy the uniform system of accounts[15] and that it would create conflicts in the exercise of federal and state jurisdiction.[16] Only one opposing witness, however, specifically expressed the view that the then-current law prohibited the states from prescribing accounts and depreciation rates for their own

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[13] Hearings on H.R. 8301, Before the Committee on Interstate and Foreign Commerce, U.S. House of Representatives, 73d Cong., 2d Sess. (April 10, 1934), pp. 136-44 (Emphasis added.); see also, Hearings on S. 2910 Before the Committee on Interstate Commerce, United States Senate, 73 Cong., 2d Sess., (March 9-10, 13-15, 1934) pp. 178-84.

[14] See *e.g.*, Hearings on S. 2910, p. 96; and Hearings on H.R. 8301, p. 191. (Statements of W.S. Gifford, President, AT&T.)

[15] See, *e.g.*, Hearings on S. 2910, p. 208; and Hearings on H.R. 8301, p. 96. (Letters of F. McManamy, Commissioner, ICC.)

[16] See, *e.g.*, Hearings on H.R. 8301, p. 243 (Statement of F.B. MacKinnon, President, United States Independent Telephone Association). How this version of section 220(j) would undermine the uniformity of the *federal* accounting system or result in conflict between federal and state authorities was not explained.

purposes, and this statement was tentative.[17]

27. Even if all the witnesses who testified concerning original section 220(j) had consistently and clearly expressed the view that the states lacked authority to prescribe additional accounts and depreciation rates absent this provision, we could accord little weight to the statements given the silence contained in the Congressional reports.[18] In

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[17] MR. GIFFORD. [Section 220(j)] throws the whole uniform accounting of the telephone industry out of line too, as I see it. It would make it necessary to keep two sets of accounts, one for the Federal Commission and one for the State commission, because each State may provide for a different system of accounting. The States will require one system of accounting, and we will also have to keep accounts for the Federal system of accounting. I do not think it is workable.

MR. MAPES. *Do the States now require you to keep accounts of any kind?*

MR. GIFFORD. *No.* The present law, the interstate commerce law, calls for accounts and that controls, as against the State laws.

MR. MAPES. Exclusively.

MR. GIFFORD. *Exclusively, and has since 1913, I think,* when the act was passed. I think the matter ought to be given very serious consideration before we go into that.

Hearings on H.R. 8301, pp. 191-92. (Emphasis added).

[18] Generally, statements made by interested parties as to the nature and effect of a bill are accorded to little or no weight if not incorporated into a committee report. These statements are very weak evidence that the legislature adopted the assumed interpretation, in view of the possibility that the committee believed the changes were unnecessary because the assumed interpretation was erroneous. See, *Sutherland Statutory Construction,* Section 48.10, and cases cited therein.

Similarly, contrary to the contention of AT&T, the mere existence of provisions in the Natural Gas Act, 15 U.S.C.A. Section 717(g) and the Federal Power Act, 16 U.S.C.A. Section 825(a) specifically reserving to the states the right to prescribe additional accounting regulations does little to assist its cause in this case. See, *e.g., Keifer & Keifer v. Reconstruction Finance Corp.,* 306 U.S. 381 (1939).

striking the compromise which became the law, Congress was completely silent as to its intent in eliminating the House version of Section 220(j).

28. H. REP. No. 1918 describes the Conference provisions as follows (p. 47):

> Section 220(j) of the Senate bill (accounts and depreciation charges) authorizes the Commission to investigate and report to Congress upon the desirability of legislation authorizing the Commission to except the carriers of any particular class or classes in any State from the requirements of the section and permitting State commissions to prescribe their own percentage rates of depreciation and systems of accounts for carriers. The House amendment (sec. 220(h)) specifically authorizes the Commission to except carriers of any particular class or classes in any State and provides (in sec. 220(j)) that the section shall not limit the power of the State commissions to prescribe percentage rates of depreciation or to require the keeping of accounts.

29. At most this legislative history indicates that the 1934 Congress was not sure whether reenactment of the Interstate Commerce Act language would or would not preempt state accounting and depreciation rules and did not choose to resolve the question at that time. One might infer that Congress believed Subsection (g) did not preempt inconsistent state commission accounting and depreciation practices. If Subsection (g) produced that effect, any further legislation to "harmonize" the powers of the regulatory commissions might be superfluous.

30. The carriers' contention that Subsection (i) demonstrates that the 1934 Congress believed it had

preempted State commission accounting and depreciation rules is not persuasive. Congress undoubtedly correctly anticipated that most State commissions would not choose to create a complete system of accounts and would be vitally interested in any rules developed by this Commission. The adoption of special notice and consultation requirements does not demonstrate that Congress assumed all states would be required to adhere to all federal accounting or depreciation rules.

31. Subsections (h)-(j) indicate that the 1934 Congress wished to achieve as much uniformity as possible without coercing any state commission to use ratemaking methods it found unacceptable. This Commission has proceeded in a manner that is consistent with that purpose for nearly four decades. We have always given special consideration to the needs and views of state commissions in developing accounting and depreciation rules and most State commissions have chosen to follow most accounting and depreciation rules prescribed by this Commission. Departures have nonetheless occurred from time to time.[19]

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[19] For example, our *Order on reconsideration* (FCC 79-678, released November 6, 1979) with respect to our Docket 21230 decision adopting revised accounting rules for plant under construction noted that many states have adopted different accounting procedures for plant under construction. We expressly acknowledged in paragraph 9 of that order that our decision would not inhibit the discretion of the state commissions. We said:

> As our *Final Order* in Docket 21230 makes clear, we have in no way attempted to influence, or interfere with, the rate making prerogatives of the New York PSC or any other state commission. The states remain free to establish intrastate rates on whatever lawful basis they choose. The fact that separate accounting information will have to be retained to accomplish this and the fact that the gathering and retention of this information may involve additional cost does not, in our view, involve any significant interference with state control over intrastate rates.

This Commission has never attempted to prevent any State commission from departing from our accounting and depreciation rules. Indeed we have expressly recognized that State commissions have a right to do so.

32. NARUC correctly notes that this Commission previously has recognized that states are not obligated to follow F.C.C. prescribed accounts in intrastate ratemaking proceedings. Thus, *In the Matter of Amendment of Part 31, Uniform Systems of Accounts For Class A and Class B Telephone Companies,* 68 F.C.C. 2d 902, 906-07 (1978), we stated:

> It should be pointed out that we are not in any way attempting to influence the intrastate ratemaking decisions the several state commissions may make in this area. Of course, they are free to adopt the same ratemaking treatment for plant under construction and interest during construction as we adopted in Docket 19129, or they may prefer to follow a different treatment. We are familiar with at least one state that by statute must follow a different treatment. We do not believe, nor is it intended that the accounting changes adopted in this proceeding impinge upon the ratemaking prerogatives of any state commission. Further, as everyone is aware, different treatment is already given to a number of items for intrastate vs. interstate ratemaking as well as among the several state commissions for intrastate ratemaking.

(Footnote 19 continued)

States have also departed from accounting practices we have prescribed in other situations. Florida requires full normalization of taxes, this Commission does not. Many states have authorized or required a deferral of expenses when we do not.

No. 79-105, at para. 7; and 47 C.F.R. Section 31.01-2(f).

33. Telephone companies have rarely challenged past state commission departures from accounting or depreciation rules prescribed by this Commission. Such challenges have not been successful. Pacific Telephone did challenge a California Public Utility Commission rate order on the grounds that it was invalid because it was based upon depreciation methods that departed from methods prescribed by this Commission. The California Supreme Court rejected that contention in *Pacific Tel. and Tel. Co. v. California*, 401 P.2d 353, 372-73 (1965).[20]

34. Thus, AT&T and GTE are asking us to repudiate nearly forty years of administrative practice and applicable state court precedents by adopting an interpretation of Section 220 that would require an unwilling state commission to follow all accounting and depreciation methods prescribed by this Commission. A very compelling showing would be required to persuade us to follow such a course.

35. GTE appears to argue that the existence of such state accounting and depreciation departures would make impossible a federal scheme of accounting and depreciation prescriptions. Past departures have not produced such an effect. If carriers maintain the records we require for purposes of interstate ratemaking, federal regulation will not be frustrated if carriers maintain additional records for other purposes.

36. Unlike GTE, AT&T appears to concede this point. AT&T argues, however, that the sanctioning of

[20] The Florida Public Service Commission concluded that it is not required to use depreciation methods prescribed by this Commission. *Southern Bell Telephone and Telegraph Co.*, 66 PUR 3d 1, 57-58 (1966).

state accounting and depreciation departures from the prescriptions contained in the *First Report and Order* would permit the states to burden the carriers with the costs of maintaining multiple sets of records. We, of course, are not free to preempt the states on the theory that they otherwise may impose administrative costs on the carriers in the course of engaging in intrastate ratemaking.

37. Our analysis of Section 220 is supported also by Section 2(b) of the Act, 47 U.S.C. § 152(b), which provides in pertinent part that "nothing in this Act shall be construed to apply or to give the Commission jurisdiction with respect to (1) charges...for or in connection with intrastate communication service by wire or radio of any carrier..." Section 2(b) does not prohibit preemption of state regulatory actions that might interfere with or tend to frustrate policies or rules we have adopted to carry out statutory objectives with respect to interstate and foreign communications. *North Carolina Utilities Commission v. FCC,* 552 F.2d 1036 (4th Cir. 1977), *cert. denied,* 434 U.S. 874 (1977) [hereinafter cited as *NCUC II*]; *North Carolina Utilities Commission v. FCC,* 537 F.2d 787 (4th Cir. 1976), *cert. denied* 429 U.S. 1027 (1976); *Puerto Rico Telephone Co. v. FCC,* 553 F.2d 694 (1st Cir. 1977); *People of California v. FCC,* 185 U.S. App. D.C. 217, 567 F.2d 282 (1966), *cert. denied* 325 U.S. 837 (1966). But where state regulation is reconcilable with federal policies or rules, there is no occasion for us to override state agency actions in furtherance of legitimate state regulatory objectives. Section 2(b) makes clear that Congress did not intend this Commission to foreclose state ratemaking actions unless those actions imperiled "important interests of national communications policy...." *NCUC II,* 552 F.2d at 1047. We have found in this instance that federal regulation will not be frustrated if carriers maintain additional records for intrastate ratemaking purposes.

Ordering Clauses

38. Accordingly, IT IS HEREBY ORDERED THAT the petition for clarification of the National Association of Regulatory Utility Commissioners, filed April 30, 1981, IS GRANTED to the extent reflected herein.

39. IT IS FURTHER ORDERED THAT the petition for reconsideration of the People of the State of California and the Public Utilities Commission of the State of California, filed April 30, 1981, IS DISMISSED as moot.

40. IT IS FURTHER ORDERED THAT the Secretary of the Federal Communications Commission shall cause this *Memorandum Opinion and Order* to be published in the Federal Register and in the Federal Communications Reports.

41. IT IS FURTHER ORDERED THAT the Secretary shall cause to be served on each party of record in CC Docket No. 79-105 and each state commission having jurisdiction over intrastate communication service a copy of this *Memorandum Opinion and Order.*

FEDERAL COMMUNICATIONS COMMISSION

William J. Tricarico *Secretary*

April 1, 1982

JOINT DISSENTING STATEMENT
OF
COMMISSIONERS JOSEPH R. FOGARTY AND
ANNE P. JONES

IN RE: EXPENSING OF STATION CONNECTIONS (CC DOCKET NO. 79-105)—PETITIONS FOR CLARIFICATION AND RECONSIDERATION.

We dissent from today's majority decision that the First Report and Order in this proceeding does not preempt State regulators from imposing accounting and depreciation rules for inside wiring which are inconsistent with those prescribed by this Commission.

In its *First Report and Order* the Commission required that account 232 of the Uniform System of Accounts be separated into two subclasses, "Station Connections-inside wiring" and "Station Connections-Other." We further required that the existing investment in Station Connections—inside wiring be amortized over a period of ten years, which represents an accelerated depreciation in contrast to past practices, and that all new investment for inside wiring be expensed rather than capitalized.

Because we wished to ameliorate the effect such an expensing plan could have upon local rates, the Commission required that expensing take place over a four-year period. In discussing this phase-in approach, the Commission stated that "...we want to allow all carriers and *state regulatory agencies* as much flexibility as possible in shifting from capitalization to expensing. Hence, for those carriers who feel that a flash-cut approach will not be too disruptive to their operations and who gain state regulatory approval, *we will allow them* to use a flash-cut approach."[1] It is clear from this discussion that the Commission intended its decision to be binding upon the States.

[1] *First Report and Order*, 85 FCC 2d 818, 829 (Emphasis added).

Since only approximately one-quarter of inside wiring costs are apportioned to the interstate jurisdiction, a phase-in which embraced only these costs would result in about 6¼, 12½, 18¾ and 25 percent of all new inside wiring costs being expenses instead of capitalized in each of the four years respectively. Surely this is not what the Commission intended. It would be nonsensical to order such a time- and resource-consuming process to achieve only such a limited effect.

We also intended the decision in our *First Report and Order* to be binding upon the States for the sound policy reason that telephone operating companies need to obtain a more rapid recovery of capital in order to modernize their plant to meet consumer needs and increased competition in the future.

Further, the FCC may ultimately order the complete detariffing and deregulation of inside wiring. The Commission anticipated this possibility in the *First Report and Order* when we said:

> "...we believe that the final answer rests not with accounting changes but rather with the ultimate deregulation of this activity. This is nothing more than a logical extension of the recommendations made by parties, our decision in Docket 20828 and our overall regulatory scheme to introduce competition whenever technological and economic circumstances are conducive to such a change."[2]

As the Commission has seen in the deregulation of customer premises equipment, asset valuation is a very

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[2] Ibid. 827.

difficult problem. If inside wiring is similarly deregulated, asset valuation will be made more difficult if this account is not capped. Furthermore, if there are two sets of accounting books required (one Federal and one State), any eventual detariffing of the inside wiring account will be made all the more difficult, since inside wiring must be deregulated *in toto* or not deregulated at all (unless the Commission contemplates deregulating only the first one-fourth of the length of the wire between the protector block and the wall outlet).

Disregarding these important considerations of Federal policy, the majority has decided that the Commission did not intend to preempt inconsistent State accounting and ratemaking practices and procedures with respect to the Station Connections-inside wiring account. At the same time, the majority allows that the Federal Communications Act—and, in particular, Section 2(b) thereof—"does not prohibit preemption of state regulatory actions that might interfere with or tend to frustrate policies or rules we have adopted to carry out statutory objectives with respect to interstate and foreign communications."[3] The continued capitalization of inside wiring by State regulatory authorities will in fact imperil and frustrate "important interests of national communications policy..."[4]—enhanced capital recovery and the effective implementation of any ultimate FCC decision on ordering the detariffing and deregulation of inside wiring.[5]

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[3] MO&O, para. 37 (Citations omitted).

[4] *North Carolina Utilities Commission v. FCC*, 552 F.2d 1036, 1047 (4th Cir. 1977), *cert. denied* 434 U.S. 874 (1977).

[5] Several State commissions have already acted to deny the application of FCC policy on inside wiring and related depreciation at the state level, and others appear to be in the process of following suit. Alabama (Sept. 4, 1981), Nebraska (Sept. 1, 1981), South Dakota (Feb. 2, 1982), and Missouri (Nov. 27, 1981) have disapproved carrier filings seeking the expensing of inside wiring.

We would not—and the majority should not—"defer to the States" on critical capital recovery issues affecting the continued viability and competitiveness of our Nation's telephone industry in providing increasingly essential interstate, as well as intrastate, facilities and services. This Commission has thrust the telephone industry into the brave new world of telecommunications competition and in doing so has overridden the strenuous and in many cases intransigent objections of many State commissions. It is therefore oddly inappropriate for this same Commission now to be so reticent about preempting the State jurisdictions from denying the industry the capital recovery necessary for its full and fair participation in this new competitive world. Here, the Commission curiously appears to have lost the courage of its pro-competitive convictions.

Because the majority's decision is inconsistent with the clear preemptive thrust and intent of the Commission's *First Report and Order* in this proceeding and, further, fails to recognize and support the integrity of our pro-competitive policies, we dissent.

APPENDIX "B"
ORDER DENYING REHEARING

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 83-1136

Virginia State Corporation Commission,

Petitioner,

versus

Federal Communications Commission
and United States of America,

Respondent.

ORDER

The petitions for rehearing and suggestions for rehearing en banc have been submitted to the Court. Upon the request for a poll of the Court on the suggestions for rehearing en banc, Judge Russell, Judge Phillips, Judge Murnaghan, and Judge Sprouse voted to deny the petitions for rehearing en banc; Judge Widener voted in favor of rehearing en banc; Chief Judge Winter, Judge Hall, Judge Ervin and Judge Chapman are disqualified. Judge Wilkinson abstains from voting.

IT IS ADJUDGED and ORDERED that the petitions for rehearing and suggestions for rehearing en banc are DENIED.

Entered at the direction of Judge Murnaghan, with the concurrence of Judge Sprouse. Judge Widener dissents.

For the Court,

JOHN M. GREACEN
CLERK

APPENDIX "C"
NOTICE OF APPEAL

IN THE UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 83-1136

VIRGINIA STATE CORPORATION COMMISSION,

Petitioner

versus

FEDERAL COMMUNICATIONS COMMISSION
and UNITED STATES OF AMERICA

Respondents

On Petition for Review of an Order
of the Federal Communications Commission

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

Notice is hereby given that the Louisiana Public Service Commission, intervenor, appeals to the Supreme Court of the United States from the decision of the United States Court of Appeals for the Fourth Circuit dated June 18, 1984, rehearing denied by order dated October 3, 1984, affirming the decision of the Federal Communications Commission released January 6, 1983.

This appeal is taken pursuant to 28 U.S.C. §1254(2).

/S/ Michael R. Fontham
Michael R. Fontham
Paul L. Zimmering
Noel J. Darce
Of STONE, PIGMAN, WALTHER,
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Attorneys for the
Louisiana Public Service Commission

APPENDIX "D"
STATE RATEMAKING ORDERS

LOUISIANA PUBLIC SERVICE COMMISSION

ORDER NO. U-15445

DOCKET NO. U-15445

SOUTH CENTRAL BELL TELEPHONE COMPANY
(NEW ORLEANS, LOUISIANA),

ex parte

In re: Proposed revision of its intrastate rates and charges for telephone service within the State of Louisiana.

This case involves the application of South Central Bell Telephone Company ("South Central Bell" or "the Company") requesting an increase in its intrastate rates and charges for the service it renders in the amount of $238,600,000.00. The Company also requested an increase in certain of its tariffs applicable to the provision of private line services. Interventions were filed by Common Cause of Louisiana, the Louisiana Telephone Answering Service Committee, the Louisiana Alarm Association, the Division of Administration of the State of Louisiana and the United States Department of Defense. The Company, intervenors and the Commission pre-filed testimony and exchanged data requests and responses. Hearings were conducted on December 13, 14, and 15, 1982, and January 17, 18, and 19, 1983.

South Central Bell is a Delaware corporation doing business as a public utility in the State of Louisiana. The last rate increase received by the Company in Louisiana was on January 21, 1981 when an increase in intrastate rates of $51,408,000.00 was approved by this Commission. *Ex Parte South Central Bell Telephone Co.*, Order No. U-14673 (La. Pub. Serv. Comm. 1981).

During the period since the last rate case when rates were adjusted to produce an additional $51,408,000.00 annually for this Bell operating company, the state of the economy has resulted in unprecedented unemployment exceeding 12% in this State alone and many industrial corporations and businesses have experienced and are experiencing operating losses in the millions of dollars. While at the same time, the rate of inflation has substantially abated and interest rates have declined appreciably.

In the light of the foregoing especially since the Company has earned a rate of return comparable to that found to be reasonable by the Commission in the last rate proceeding, we find no justification for an increase in rates at this time.

Accordingly,

IT IS HEREBY ORDERED that South Central Bell's request for an increase in its intrastate rates in the amountof $238,600,000.00 is denied.

BY ORDER OF THE COMMISSION:
BATON ROUGE, LOUISIANA
MAY 19, 1983

/S/ THOMAS E. POWELL
CHAIRMAN

/S/ ED KENNON
COMMISSIONER

/S/ LOUIS J. LAMBERT, JR.
COMMISSIONER

*Commissioner John Schwegmann concurs in part and dissents in part.

/S/ JOHN F. SCHWEGMANN
COMMISSIONER

/S/ GEORGE J. ACKEL
VICE CHAIRMAN

/S/ LOUIS S. QUINN
SECRETARY

* (Separate Opinion Attached)
[Opinion of Commissioner Schwegmann omitted]

LOUISIANA PUBLIC SERVICE COMMISSION

ORDER NO. U-15445-A

DOCKET NO. U-15445

SOUTH CENTRAL BELL TELEPHONE COMPANY
(NEW ORLEANS, LOUISIANA),

ex parte

In re: Proposed revision of its intrastate rates and charges for telephone service within the State of Louisiana.

This case is before the Commission pursuant to an order of the United States District Court for the Middle District of Louisiana, Honorable John V. Parker, which was issued on June 27, 1983.

In May, 1982, South Central Bell Telephone Company ("South Central Bell" or "the Company") requested an increase in its intrastate rates and charges in the amount of $238.6 million. Included within that rate request was a request for more than $40 million in revenues that the Company alleged it would need if the Commission adopted certain methodologies for computing the expenses of the Company prescribed by the Federal Communications Commission ("FCC").

Specifically, South Central Bell asked the Commission to employ, for the purpose of intrastate ratemaking, Equal Life Groups and Remaining Life depreciation

methods rather than the Straight Line Vintage Life Group method which had previously been employed by the Commission and consistently approved by the courts of this State. In addition, South Central Bell sought to have the Commission "expense" 75 per cent of the costs associated with station connections, rather than capitalizing these costs as the Commission had done in the past. At the hearings of the rate case, South Central Bell alleged that the FCC had *mandated* the use of the new methods in an Order issued January 6, 1983 Memorandum Opinion and Order, CC Docket No. 79-105 (FCC, Jan. 6, 1983). The net effect of the adoption of these proposals would have been to increase the Company's intrastate expense level by $40,506,000.

After extensive hearings on the rate request, this Commission issued Order No. U-15445 (Commissioner Schwegmann concurring in part and dissenting in part). In light of unprecedented unemployment levels, the state of the economy, the fact that inflation has substantially abated, the decline in interest rates and the fact that the Company had earned a rate of return comparable to that found reasonable in the last rate proceeding, among other factors, this Commission denied the Company's rate request. However, the Commission did not make a finding at that time of the fair rate of return on equity for South Central Bell, since no increase in revenues was required.

On May 19, 1983, South Central Bell filed suit in the Federal court seeking the issuance of a preliminary injunction ordering the Commission to recognize the FCC-mandated depreciation rates. On June 27, 1983, the Honorable John V. Parker ordered that within 10 days the Louisiana Public Service Commission "issue an order which provides for the collection of rates by (South Central

Bell) sufficient to recover the intrastate revenue requirement resulting from the FCC-prescribed depreciation rates and methodologies". It is this ruling by a federal judge ordering the Louisiana Commission to increase *intrastate* rates which forces the Commission to issue this Order.

This Commission is the body constitutionally vested with the duty and authority to regulate all common carriers and public utilities providing intrastate service in Louisiana. We believe that this most recent attempt by the FCC to preempt this State's authority to regulate intrastate rates and services is inconsistent with the Communications Act and may run afoul of the limitations contained in the United States Constitution protecting state sovereignty. However, we are faced with an order of a federal judge which has not yet been overturned. Although we believe that the order is invalid, we are compelled to obey it at this time. For that reason we will reconsider the case in light of the increased expense level of $40,506,000 resulting from the FCC Order. (Although the Company asked the federal court to increase revenues in the amount of $41,463,000, that request was based on 1983 data, none which was ever presented to the Commission. The appropriate figure based on test year data reviewed by the Commission is $40,506,000).

As noted, the Commission denied the rate request of South Central Bell in May, but did not make a determination of the fair rate of return on equity. The currently authorized overall rate of return of South Central Bell was set in 1981, when market interest rates were significantly higher than they are today. The prime rate has remained at about 10½ per cent for some time. In addition, the rate of return earned by the Company includes a return on unamortized investment tax credits, which constitute

approximately 7.5 per cent of South Central bell's total capital. In fact, however, these tax credits are cost-free investment of the Company, so in reality the rate of return on its investor-supplied equity is higher than that authorized for regulatory purposes. When these factors are viewed in light of the continued low level of inflation, and continued high unemployment, we find that a rate of return on equity of 12 per cent is sufficient to assure confidence in the Company's financial soundness, will be adequate to maintain and support its credit and will permit it to raise the capital necessary to perform its public functions. The gross revenue increase necessary to produce a rate of return on equity of 12 per cent after taking account of the ratemaking adjustments proposed by a consultant of the Commission, Bruce M. Louiselle, and recognizing the full amount of the FCC-mandated accounting changes as quantified by South Central Bell, is $12,700,000.

The increase in rates approved in this Order shall be distributed as follows:

ITEM	AMOUNT
Basic Local Flat Rate Exchange and Related Services; Including Residence and Business basic local service, Centrex Access Measured PBX, etc.	$ 1,000,000
Service Charges	1,000,000
Miscellaneous Services: 2,000,000 Including Toll Terminals, Grouping Service, Zone Charges, etc.	
Network Services	2,000,000
Customer Premises Products	6,000,000
Unrecovered Telephone Equipment Charge	700,000

Total Billing Charge	$12,700,000
Less Independent Company Settlements	(257,000)
	$12,443,000

Accordingly,

IT IS HEREBY ORDERED THAT:

(1) South Central Bell Telephone Company be permitted to increase its tariffs in the amounts directed by the Commission sufficient to increase its gross annual revenues by $12,700,000;

(2) This increase shall be implemented subject to refund with interest at 12 per cent per annum and the Commission reserves the right to require further security from the Company;

(3) No increases shall become effective until such time as the Company files and the Commission accepts tariffs drawn in accordance with this order and which provide for a refund plan which includes provisions for refunds to ratepayers who discontinue or change service during the time that these increased rates are in effect.

BY ORDER OF THE COMMISSION:
BATON ROUGE, LOUISIANA
JULY 7, 1983

/s/ THOMAS E. POWELL
CHAIRMAN

COMMISSIONER

/s/ LOUIS J. LAMBERT, JR.
COMMISSIONER

*Commissioner John Schwegmann concurs in part and dissents in part.

COMMISSIONER

/s/ GEORGE J. ACKEL
VICE CHAIRMAN

/s/ LOUIS S. QUINN
SECRETARY

* (Separate Opinion Attached)

Commissioner Schwegmann, concurring in part and dissenting in part,

At the time of the decision of the South Central Bell rate case, I stated the position that a maximum rate increase of $21,989,000 should be granted the Company in view of the burdensome effect of any increase on consumers. This increase would have produced a 14 per cent rate of return on equity.

I agree that the federal court order should be complied with in full, recognizing that full $40.5 million in accounting changes sought by the Company. After giving effect to this increase in expenses, I would still raise the revenues of the Company by the gross amount (after independent company settlements) of $21,989,000. This increase would produce a rate of return on equity of 12.6 per cent. I recognize that this rate of return is below the amount I deemed reasonable in May, but I believe we still must balance the investor interests against the interests of consumers, and in light of all relevant factors, this rate of return is still reasonable.

/s/ JOHN F. SCHWEGMANN

JOHN F. SCHWEGMANN, Commissioner

A-104

LOUISIANA PUBLIC SERVICE COMMISSION

GENERAL ORDER

In re: Reaffirmation of the applicability of state regulatory principles to telephone terminal equipment and telephone accounting practices.

This General Order is issued to set forth the scope of regulatory authority over telephone tariffs that is exercised, and will continue to be exercised absent a contrary and authoritative judicial order, by the Louisiana Public Service Commission. In the view of the Commission, this statement of regulatory policy is necessary because of orders issued by the Federal Communications Commission ("FCC") which attempt to preempt the authority of this Commission and other state regulatory agencies to regulate certain intrastate activities of communications common carriers.

In a proceeding generally known as the "Second Computer Inquiry," the FCC last year stated its intention to preempt the authority of state regulatory agencies to establish tariffs for the marketing of "terminal equipment" by communications common carriers. "Final Decision," In the Matter of Amendment of Section 64.702 of the Commission's Rules and Regulations (Second Computer Inquiry) (hereinafter referred to as "Second Computer Inquiry"), Docket No. 20828, 77 F.C.C. 2d 384 (Released May 2, 1980); "Memorandum Opinion and Order" in Second Computer Inquiry, 84 F.C.C. 2d 50 (Released Dec. 30, 1980). "Terminal equipment" is that equipment located on

a customer's premises which the customer uses to transmit and recieve communications through the telecommunications network. Thus, it includes equipment ranging from the ordinary telephone to the sophisticated equipment used on the premises of businesses. The action of the FCC is designed to further an asserted federal policy of "deregulation" and would permit the Bell System, along with other common carriers, to set the prices for terminal equipment free of rate regulation by any state regulatory agency or the FCC. In the words of the FCC, the Second Computer decision has the effect of "eviscerating state jurisdiction to establish charges for this terminal equipment in a manner that conflicts with federal interests...." Memorandum Opinion and Order in Second Computer Inquiry, 84 F.C.C. 2d 50, 103 (Released Dec. 30, 1980).

The Louisiana Commission did not learn of the scope and potential impact of the decision in the Second Computer Inquiry until recently. Although the ruling attempts a vast reordering of federal and state regulatory prerogatives, no public notice issued by the FCC prior to its Final Decision even mentioned the possibility that any preemption of state authority might be attempted. The Second Computer Inquiry was orignially undertaken to redefine the distinctions between communications and data processing services previously adopted by the FCC. Notice of Inquiry and Proposed Rulemaking in Second Computer Inquiry, 61 F.C.C. 2d 103 (Released Aug. 9, 1976); Supplemental Notice of Inquiry and Enlargement of Proposed Rulemaking in Second Computer Inquiry, 64 F.C.C. 2d 771 (Released March 8, 1977); Tentative Decision and Further Notice of Inquiry and Rulemaking, 72 F.C.C. 2d 358, 440-43 (Released July 2, 1979).

The potential consequences of the regulatory policies

of the FCC began to become apparent, however, when South Central Bell Telephone Co. requested drastic increases in intrastate rates to satisfy prospective changes in depreciation rates and other accounting practices prescribed by the FCC. See *Ex parte South Central Bell Telephone Co.*, Order No. U-14673 (La. Pub. Serv. Comm'n., Jan. 21, 1981) at 30 *et seq.* These accounting changes are associated with the process of deregulation and are designed in part to allow the telephone company an accelerated return of capital to permit the transfer of assets to an unregulated Bell System subsidiary at low prices. Final Decision in Second Computer Inquiry, 77 F.C.C. 2d 384, 449 (Released May 2, 1980). Faced with the claim for substantial intrastate rate increases to promote federal objectives, this Commission initiated an inquiry into the scope and impact of the Second Computer decision and related actions of the FCC. *Ex parte South Central Bell Telephone Co.*, Order No. U-14673 (La. Pub. Serv. Comm'n., Jan. 21, 1981) at 30 *et seq.*

The Second Computer decision, if it is implemented, will have a number of consequences for state regulatory agencies and intrastate ratepayers. First, the state agencies will be precluded from regulating the Bell System and other common carriers in the marketing of terminal equipment. Consumers will be forced to pay whatever prices can be exacted by these carriers in light of local market conditions. Second, state regulatory agencies will be unable to foster the goal of universal service by permitting the rates for terminal equipment, which ordinarily reflect at least the full intrastate and interstate cost of this equipment, to defray part of the expenses associated with basic service. Thus, intrastate rates will increase. Third, the other actions of the FCC taken to implement the deregulation decision, such as the prescription of accelerated depreciation rates, will cause intrastate rates to increase even further.

The attempted preemption of state ratemaking authority by the FCC is ironic because the FCC has never established the tariffs for most enhanced services, nor do federal tariffs exist for most of the terminal equipment provided to consumers by common carriers. The establishment of these rates has historically been the prerogative of state regulatory agencies.

Much of the plant devoted to communications service in this country is devoted to both intrastate and interstate use. Thus, a piece of terminal equipment may be used primarily for intrastate calls in the local exchange and intrastate toll calls, but it may also be used for interstate toll calls. A similar joint use is made of the inside wiring on the customer's premise, the wiring that connects customers to switching facilities, some of the central office equipment, and other plant. Under the decision of the United States Supreme Court in *Smith v. Illinois Bell Telephone Co.*, 282 U.S. 133, 51 S.Ct. 65 (1930), a fair apportionment is required of the costs attributable to each jurisdiction in order to fairly account for these costs. Over time, a separations process has developed to accomplish this objective. Of the joint costs, which are apportioned in part according to the use of the facilities, the majority are assigned to the intrastate jurisdictions.

While the costs associated with terminal equipment are divided between the state and federal jurisdictions, the responsibility for tariffing jointly used terminal equipment has always rested with the state regulatory agencies. Thus, the FCC recognized that the only federal tariffs for terminal equipment involve equipment used exclusively in "interstate or foreign communications" and that all terminal equipment subject to the separations process is "tariffed at the state level." Memorandum Opinion and

Order in Second Computer Inquiry, 84 F.C.C. 2d 50, 67, 66 (Released Dec. 30, 1981).

The objectives of regulation on the intrastate level vary from state to state. However, one general objective of utility regulation is to ensure that an entity enjoying "natural monopoly" status does not charge excessive prices to consumers. A second objective is to ensure the ready availability to the general public of common carrier services: the concept of universality of service. Regulatory agencies may act to ensure that communications service is provided to all who request it at reasonable prices. These regulatory policies have long been accepted in Louisiana.

The method by which regulatory agencies protect the consumer, while ensuring the financial health of the utility, is through the ratemaking process. As Professor Priest indicates in his treatise, "(e)very state has...established a regulatory agency" and "the early predicates for regulation were developed under the guidance of state tribunals." A.J.G. Priest, Principles of Public Utility Regulation (Michie Co., 1969) at 26. The ratemaking process is designed to set utility prices at a level that will allow only a fair rate of return to the utility. *Id.* at 191 *et seq.* The overriding principle is the "protection of the public interest." *Id.* at 193.

Generally, only communications common carriers have been regulated in the marketing of terminal equipment. The prices charged by independent suppliers of terminal equipment, that do not engage in common carrier actaivities, have not been regulated. The only companies "deregulated" by the FCC are the Bell System and other common carriers. The Bell System, however, enjoys enormous economic power in the United States. South Central

Bell Telephone Co. has natural monopoly status in this state. In only a few areas of the state do market conditions reflect any significant "competition" in the marketing of terminal equipment. In most areas, an unregulated telephone company would be free to charge excessive prices.

A full implementation of the deregulation decision of the FCC, including the changes in accounting practices proposed to further the goal of deregulation, could cause increases in Louisiana intrastate rates of more than $100 million annually. The economic power of the Bell System would be enhanced. Consumers would be unprotected in obtaining terminal equipment from a natural monopoly. The policy of universal service would be retarded.

The Louisiana Constitution and other laws of this State vest this Commission with regulatory authority over the telephone company. This law provides the Commission with broad authority over regulated utilities. Concomitantly, the Commission has a duty to exercise its authority in reasonable fashion to protect consumers while ensuring fairness to utilities. The law of the State and our longstanding regulatory policies do not permit the Commission to meekly accede to an ill advised policy of regulatory abdication advocated by a federal agency.

In the view of this Commission, the Communications Act of 1934 specifically reserves to the states the authority to prescribe rates for equipment used primarily for intrastate communications. 47 U.S.C. §§152(b), 221(b). Even if it did not, the attempt of a federal agency to displace our authority to protect Louisiana citizens, while providing no assurance that federal regulations will protect them, runs afoul of constitutional limitations protecting state sovereignty. National League of Cities v. Usery, 426 U.S. 833, 96 S.Ct. 2465 (1976).

In order to place the FCC and South Central Bell Telephone Co. on notice of the regulatory policy of this State as it relates to the policies announced by the FCC, this Commission hereby orders:

(1) The marketing of terminal equipment by communications common carriers will continue to be the subject of rate regulation by this Commission, even after March 1, 1982. This order will apply to any attempt of the Bell System to market this equipment through a separate subsidiary.

(2) Depreciation rates for imbedded terminal equipment, and all other equipment historically regulated in the intrastate jurisdiction, will be set according to policies approved in this State. They will not be established to further a policy of "deregulation" of the FCC.

(3) Changes in accounting procedures proposed by common carriers will be examined for their consistency with the approved regulatory practice of this State and will be approved or disapproved on this basis, and this basis only.

The staff, special counsel and consultants of the Commission are instructed to take the necessary actions to ensure the implementation of this Order. The Order does not reflect any change in the regulatory policy of this Commission. However, it is necessary in light of the policies announced by the FCC.

BY ORDER OF THE COMMISSION
BATON ROUGE, LOUISIANA
JUNE 30, 1981

/s/ ED KENNON
CHAIRMAN

/s/ THOMAS E. POWELL
VICE CHAIRMAN

/s/ LOUIS J. LAMBERT, JR.
COMMISSIONER

/s/ GEORGE J. ACKEL
COMMISSIONER

/s/ JOHN F. SCHWEGMANN
COMMISSIONER

/s/ LOUIS S. QUINN
SECRETARY

BEFORE THE
LOUISIANA PUBLIC SERVICE COMMISSION

DOCKET NO. U-15955

EX PARTE APPLICATION OF
SOUTH CENTRAL BELL TELEPHONE COMPANY
FOR A REVISION OF ITS INTRASTATE
RATES AND CHARGES

ORDER NO. U-15955-A

I. INTRODUCTION

This case involves the application of South Central Bell Telephone Company ("South Central Bell") for an increase of its intrastate rates and charges of $407,337,000. The case involves unprecendented issues in telecommunications because it requires the Commission to set rates for the period following the divestiture of South Central Bell and other Bell operating companies by the American Telephone and Telegraph Co. ("AT&T") pursuant to the settlement of the antitrust suit brought against AT&T by the Justice Department. The settlement was modified and approved by a United States District Court in *United States v. American Telephone & Telegraph Co.*, 552 F.Supp. 131 (D.D.C. 1982), *aff'd sub. nom., Maryland v. United States,* __ U.S. __ (1983). In addition, this case follows the decision of the Federal Communications Commission preempting state jurisdiction over certain services and offerings of telecommunications common carriers and deregulating these areas. *Computer & Communications Industry Ass'n v. Federal Communications Commission,* 693 F.2d 198 (D.C. Cir. 1982), *cert. denied sub. nom. Louisiana*

Public Service Commission v. Federal Communications Commission, __ U.S. __ (1983).

The company filed its rate application November 4, 1983. It requested general rate relief, but also asked for an interim, emergency rate order to make up revenues assertedly to be lost January 1, 1984 as the result of divestiture and deregulation. On December 30, 1983, the Commission issued Order No. U-15955, granting the company authority to file access tariffs sufficient to produce annual revenues of $141.5 million, with the charges to be assessed entirely to interexchange carriers. This amount was later reduced to about $138 million by agreement of South Central Bell and the principal interexchange carrier, AT&T Communications of the South Central States, Inc. ("ATTCOSCSI"), a subsidiary of AT&T.

South Central Bell formerly was a wholly owned subsidiary of AT&T. It now is a wholly owned subsidiary of Bell South Corporation ("BellSouth"), a corporation that was "spun off" by AT&T at the time of divestiture. Southern Bell Telephone & Telegraph Company is also a wholly owned subsidiary of BellSouth. To accomplish the divestiture, South Central Bell transferred most of its customer premises equipment ("CPE") to a subsidiary of AT&T and transferred other equipment, assets and personnel to other entities.

Interventions were filed in this proceeding by a number of parties, including ATTCOSCSI, the Alarm Association of Louisiana, Southern Pacific Communications, Southern Message Service, Inc., Radiofone, Inc., the American Petroleum Institute's Central Committee on Telecommunications, Louisiana Telephone Association, Lafourche Telephone Company, and the Regulatory Law

Office, U.S. Army Legal Services Agency. A hearing was conducted on the interim application December 8, 1983, and hearings for the cross-examination of witnesses presented by South Central Bell, the Commission Staff, and intervenors were held April 10, 11 and 12, and May 15, 16 and 31, 1984.

II. THE RATE APPLICATION

In a normal rate case, determining the revenue requirements of the utility requires five steps: 1) choosing the test period for the measurement of the earnings of the company; 2) calculating the rate base in the test period; 3) finding the adjusted operating income for the period; 4) determining the fair rate of return; and 5) adjusting rates to allow the utility the opportunity to earn this rate of return. Traditionally, the Commission has used a past test period and adjusted the data for known changes to occur when rates are in effect and, if necessary, for attrition.

In this case, the traditional rate-making mechanism is complicated enormously by divestiture and deregulation. Because of these events, historic data is not necessarily indicative of future conditions. The splitting of the assets, personnel, offerings and services of the company do not necessarily have a proportionate impact on expenses and revenues, so it is impossible to predict the rate levels for the divested company that are necessary to produce the fair rate of return. Moreover, because of divestiture and deregulation, the rate filing is based to an unprecedented degree on assumptions and estimates, many of which were made by employees of AT&T or employees of South Central Bell who are now employed by AT&T. The presumptive validity attaching to the books and records of a utility in a normal case, when this material is kept in accordance

with standard and accepted accounting practices, does not apply to the unique decisions made in connection with the reorganization of the industry, especially since an entity that is now a potential competitor of South Central Bell controlled many divestiture decisions.

In addition, because divestiture was a mammoth task, involving decisions by hundreds of employees of AT&T and South Central Bell, it is impossible to test these decisions for their prudence and regulatory propriety. This Commission simply does not have resources to match those devoted by the telephone company to this effort. Thus, regulatory scrutiny in the normal sense is not possible.

These observations do not mean that rates should not be established for the post-divestiture period, but that any prognostication of the impact of these events is unreliable and the capacity of the Commission to protect the interests of ratepayers is reduced. The rate setting process requires an unusual dose of judgment. The handicaps under which the Commission must set rates mandate caution in analyzing the company's forecast of a need for additional revenue.

A. The Test Year.

South Central Bell proposed the use of a fully forecasted 1984 test year. The Commission traditionally has relied on actual data for a recent past test year, but recognizes that divestiture and deregulation make past data unreliable for predicting the future. Nevertheless, the use of actual data, adjusted to the extent possible, for divestiture, is likely to be more representative, and permit better regulatory scrutiny, than data based entirely on estimates. Therefore, the Commission adopts the test year

1983. South Central Bell was given the opportunity to suggest all necessary adjustments to this data.

B. The Rate Base.

The Commission adopts the rate base proposed by its regulatory consultant, Mr. Kenneth Gallagher. The adjustments proposed by Mr. Gallagher are consistent with the traditional practices of the Commission and reflect reasonable adjustments to the estimates proposed by the telephone company. The Commission notes that the estimates of 1984 separations factors made by South Central Bell increase the rate base by $125 million as compared to the 1983 factors. These estimates were not supported in any detail by the company and could not be checked by the Commission's consultants.

In addition, it should be noted that given the impact of divestiture, it is no longer necessary to separate customer deposits into intrastate/interstate components. The amount to be properly deducted from the intrastate rate base is the entire unseparated amount.

South Central Bell recently spun off its directory assistance operation to a subsidiary of BellSouth. The consultants of the Commission indicated that even though South Central Bell will receive a percentage of directory assistance revenues, these revenues will decrease. Pursuant to their recommendation, South Central Bell is directed to maintain its records in a manner that will permit the Commission to determine in the future the revenues lost because of the spin off. For the test year, only an adjustment to working capital is required to achieve the proper ratemaking treatment of the directory assistance matter.

The adjusted rate base is set forth below:

RATE BASE FOR TEST YEAR 1983

($1,000)

Telephone Plant in Service		2,347,680
Depreciation Reserve		(315,530)
Net Telephone Plant		2,032,150
Long-Term Telephone Plant Under Construction		22,971
Short-Term Telephone Plant Under Construction		24,545
Property Held for Future Use		335
Working Capital		(15,372)
Less: Non-Investor Supplied Capital		
Customer Deposits Including Interest	(13,064)	
Accumulated Deferred Income Taxes	(249,249)	
Pre-1971 Investment Tax Credits	(1,293)	
Reserve for Uncollectibles	(1,355)	
Total Non-Investor Supplied Capital		(264,961)
CPE Phase-Out		(18,457)
Capitalized CPE Transfer		290
Rate Base		1,781,501

C. Adjusted Operating Income.

The net operating income for 1983 was adjusted for divestiture. Mr. Gallagher recommended that a number of further adjustments proposed by South Central Bell be

accepted and that others be rejected. In addition, he proposed several adjustments to this data. The recommendations of Mr. Gallagher all appear reasonable and are adopted by the Commission. Only the following adjustments require discussion.

1. Changed divestiture ratios.

Mr. Gallagher recommended that the ratios for the computation of certain payroll adjustments be changed from those proposed by the company. South Central Bell developed the ratios using a post-divestiture forecast of the number of employees in 1984 and a pre-divestiture forecast for 1984, though the 1983 number of employees was used to price out the adjustments. With respect to the test year labor costs, Mr. Gallagher's adjustment to reflect the effect of the actual number of employees retained upon divestiture is accepted. The revised proforma wage adjustments proposed by Mr. Gallagher are also accepted. Mr. Gallagher's method of comparing the post-divestiture actual number of employees to the 1983 figures used to develop the pre-divestiture adjustment is the correct procedure to develop the appropriate ratios.

2. Reimbursements.

The company received reimbursements from AT&T for expenses previously financed by ratepayers. These funds should be amortized back to ratepayers over a reasonable period, as recommended by Mr. Gallagher.

3. General Services and Licenses—
Central Service Organization.

Mr. Gallagher estimated the amount of General

Services and Licenses expense and the Central Service Organization expense by starting with and adjusting the 1983 License Contract expense. The Commission approves this method, which is a reasonable method of projecting this expense. The Commission adopts Mr. Gallagher's recommendations concerning the divestiture ratios to be applied to various expense categories and the removal of certain categories for ratemaking purposes.

4. Adjustment to Previously Deferred Research Costs.

South Central Bell retained 100 per cent of previously deferred research costs rather than transferring some of these costs, along with assets, to AT&T. Mr. Gallagher recommended that only a percentage of these costs be recognized for ratemaking treatment, since research improved all of the company's technology, including that transferred to AT&T. A portion of the research costs will be amortized to ratepayers as recommended by Mr. Gallagher.

5. Depreciation and Expensing of Station Connections.

In 1983, the Commission rejected the implementation of certain accounting changes approved by the Federal Communication Commission and assertedly made mandatory for state regulatory agencies in a Preemption Order issued by the FCC. South Central Bell obtained a preliminary injunction from a federal court requiring that the additional book expenses be recognized and that a rate increase be granted, subject to refund, to permit the collection of these expenses. The increase was approximately $41 million. The decision is now on appeal to the United States Court of Appeals for the Fifth Circuit.

The expense in the test year for these items for the post-divestiture South Central Bell causes the need for additional revenues of approximately $41 million. The 1984 represcriptions recently approved by the FCC require additional revenues of $21.72 million. In sum, then, the total revenue effect of the mandated changes in depreciation methods and rates is approximately $62.7 million.

Except for the federal court order, the Commission would not approve the new depreciation methods or the expensing of station connections. However, because of the preliminary injunction, the additional expenses will be recognized for ratemaking purposes, pending the decision of the courts on the appeal of the preliminary injunction.

The rates attributable to these expenses will be imposed subject to refund. South Central Bell is directed to keep records sufficient to make the necessary refunds.

6. Amortization of Excess Deferred Income Taxes.

Due to the change in the federal income tax rate, the Company has accumulated "excess" deferred taxes. The deferred taxes were accumulated at a 48 per cent rate, but the tax liability now only reflects a rate of 46 per cent, meaning that funds have been accumulated for which there is no tax liability. The company proposes to return this excess to its ratepayers over the life of the plant which gave rise to the deductions. It asserts that this treatment is in accord with generally accepted accounting principles and also that if the company returned these deferred taxes more rapidly to ratepayers it would jeopardize its ability to defer federal income taxes pursuant to the Internal Revenue Code.

Mr. Gallagher recommended that these excess deferred taxes be amortized to ratepayers over a two year period. These excess deferred taxes have arisen as a result of accounting convention and do not in fact constitute a potential liability of the Company. The money was advanced by ratepayers. The Company has offered no reason to support its retention of these funds for any longer than two years.

Finally, there is no indication that South Central Bell runs a significant risk of losing its ability to defer federal income taxes if these excess deferred taxes are amortized over a two year period. The Commission will still permit the normalization of the tax effects of accelerated depreciation. In addition, various other state regulatory commissions have required that such excess reserves be amortized over a shorter period of time than the life of the associated plant and there have been no adverse effects on the ability of the regulated companies to defer federal taxes.

7. Interest during construction.

Interest during construction should be reflected at the overall cost of capital approved by the Commission, both for long-term and short-term plant under construction. The appropriate adjustment at the rate of return of 11.82% is $651,000.

8. Tax effect of proforma interest.

Mr. Gallagher indicated that the test year tax expense be adjusted to reflect the proforma amount and cost rate of debt adopted for ratemaking purposes. This recommendation is consistent with the standard practice of the Commission and is adopted.

The adjustments to operating income are set forth below:

ADJUSTED OPERATING INCOME

($1,000)

Test Year Net Operating Income	90,717
ADJUSTMENTS	
Annualize 4/83 Management Salary Increase	(400)
ES, CPE, FSS Reimbursements	1,401
AMPS Reimbursement	760
8/83 Tariff Increase	8,205
Annualize 8/83 Non-Mgmt. Salary Increase	(2,924)
Annualize 10/83 Management Salary Increase	(1,564)
Annualize 1983 Pensions Accrual Increase	(396)
Annualize Independent Company Settlements	238
Remove Divestiture "Get Ready" Costs	227
Annualize RL/ELG—1983	(4,460)
Remove ASD Formation Costs	316
Remove Regional Service Company Costs	2,659
Proforma Non-Management Savings Plan	(76)
Proforma 1984 FICA	(386)
Proforma 4/84 Management Salary Increase	(529)
Proforma 8/84 Non.-Mgmt. Salary Increase	(4,172)
Proforma 10/84 Management Salary Increase	(683)

Proforma 1984 Property Tax Increase	(1,693)	
Proforma 1984 Revenue—ATTIX/ EBO	376	
Proforma 4/85 Management Salary Increase	(989)	
ESC—100%	(9,676)	
Adjust Test Year Payroll for Divestiture Ratio	8,910	
Amortization of Reimbursements	178	
CPE Phase-Out	3,463	
CPE Transfer to Employees	234	
Official Toll	(2,284)	
Contract Charging	(4,016)	
Adjust IDC to 11.82	651	
Interest on Customer Deposits	(648)	
Amortization of Excess DFIT	1,536	
Proforma Interest	9,772	
12/83 Tariff Change	(1,084)	
RL & ELG—1984	(10,877)	
Total Adjustments		(7,931)
Adjusted Net Operating Income		82,786

D. Fair Rate of Return

The determination of the fair rate of return is also influenced by divestiture and deregulation. In the past, the Commission has regulated South Central Bell on the basis of a reasonable capital structure for the Bell System. The company has now been divested and is wholly owned by BellSouth. In addition, the Commission now must determine a reasonable return on equity for the divested company rather than for a company that is part of the Bell System.

Dr. Richard L. Lurito, a consultant of the Commission, testified that a reasonable capital structure for BellSouth would include 45 per cent long term debt, 6 per cent short term debt and 49 per cent common equity. In the 1980 South Central Bell case, Docket No. U-14673, this Commission used a capital structure containing only 45 per cent equity for regulatory purposes; this capital structure was also used in the last case. Thus, the recommendation of Dr. Lurito would permit a significant increase in the equity ratio.

Under the divestiture order of the federal court, the divested Bell subsidiaries were required to have equity ratios of at least 55 per cent. However, the divestiture order does not purport to determine a reasonable capital structure of these subsidiaries for regulatory purposes. The 55 per cent requirement is partly a function of the historic refusal of the Bell System to move toward a reasonable capital structure and the court's desire to avoid exploitation of the subsidiaries by AT&T. It is not binding on this Commission.

Dr. Lurito performed studies to determine whether his recommended capital structure provides adequate safety to South Central Bell and found that it ensures more than a reasonable margin of safety. This finding is especially supportable because other utilities in this State with fewer assets and greater risk than South Central Bell are able to obtain reasonable financing with equity ratios below 40 per cent. The Commission is reluctant to approve any increase in the equity ratio, but will adopt the recommendation of Dr. Lurito for this case with the provision that to conform to the regulatory goal in this State, the utility plan its future financing to achieve the most economical capital structure and equity ratio.

Dr. Lurito also provided the proform cost of debt of South Central Bell and BellSouth and indicated that it may be preferable to use the cost rates of South Central Bell until experience shows the effect on the BellSouth cost rates of its creation of certain new subsidiaries. The Commission will accept this recommendation, at least for this case.

The following recommendations were submitted for the fair rate of return on equity:

Mr. J. D. Matheson, Jr., the witness of South Cental Bell	16-18%
Dr. Lurito	15%
Mr. Mark Langsum, the witness of the U.S. Army	13.5-14.5%

In evaluating these recommendations, the Commission is mindful of the following tenets. First, the company is entitled to earn a rate of return that is "commensurate with returns on investment in other enterprises having corresponding risks" and "sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain credit and to attract capital." *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 603, 64 S.Ct. 281, 288 (1944). This, however, is but the first part of the Commission's inquiry. The Commission is also bound to "provide appropriate protection to the relevant public interests, both existing and foreseeable." *In re Permian Basin Area Rate Cases*, 390 U.S. 747, 792, 88 S.Ct. 1344, 1373 (1968). Furthermore, the Commission is bound to assess these requirements of the broad public interest "at each step of its regulatory process." 390 U.S. at 791, 88 S.Ct. at 1372. A balance must thus be struck between investor and consumer interests.

Second, unamortized investment tax credits constitute approximately 8.1 per cent of South Central Bell's total investor-supplied capital. If such unamortized investment tax credits are not deducted from the Company's rate base, South Central Bell will in fact be permitted the opportunity to earn a higher rate on its *actual* equity investment. Although these unamortized investment tax credits are treated as if they were investor-supplied, they actually have zero cost to the Company. If the unamortized investment tax credits are deducted from rate base, there might be a disadvantageous tax consequence. However, the Commission is not precluded from considering this factor in determining the rate of return on equity that will ensure the financial integrity of the utility.

Third, inflation continues to be relatively low. Investors are receiving a higher *real* return on their investment than they have for some time. The use of historic studies concerning the investor's required rate of return may overstate the real return requirement.

Fourth, the preliminary injunction requires the Commission to permit faster capital cost recovery methods than historically have been allowed. The increase in cash flow of $62.7 million annually reduces the investment risk of South Central Bell and gives it a better "quality" of earnings.

In the final analysis, the fair rate of return on equity is a matter of regulatory judgment. This rate of return will be fixed at 14.75 per cent. The overall fair rate of return is 11.82 per cent.

E. Revenue Requirement.

To produce the fair rate of return, a rate increase of $126,393,000 is required after reflecting the fact that access rates charged to interexchange carriers will produce $128,790,000 of revenues, as discussed below. South Central Bell has assured the Commission that it will pursue a construction program costing $300 million or more in the next 12 months, allowing it to improve and upgrade the quality of service in this State. The Company will be required to perform this undertaking, especially in light of the rate relief provided in this order.

III. ADDITIONAL MATTERS.

The following additional matters must be dealt with in this Order.

First, divestiture and deregulation have created a new telephone company and shifted much of the burden of paying for telecommunications services among classes of customers. New issues in rate design are presented. The goal of universal service is threatened by the spectre of so-called "competition," which in the world of the telephone company mandates increases rather than decreases in price. A full analysis of these issues is necessary. Therefore, the Staff is directed to receive evidence and make recommendations concerning these matters. However, the Commission hereby orders that the increase applied to residential exchange service not exceed $2.00 per month and the increase to business exchange service not exceed $4.00 per month, and authorizes the implementation of these two tariffs.

Second, pursuant to the recommendation of Bruce

M. Louiselle, a Commission consultant, and the current cost study showing the need for $128,790,000 in revenue resulting from the loss of the toll services of South Central Bell, the access charge assessed to interexchange carriers will be fixed at $128,790,000. The so-called threat of "bypass" has not been shown to be serious enough to justify reducing these tariffs any further.

Third, the Commission is concerned that accounting guidelines be developed to ensure that interexchange carriers bear the full cost of ensuring "equal access" pursuant to the divestiture order. In the continuing proceedings, the Staff is directed to analyze this issue and make recommendations.

Fourth, the Commission Staff is directed to conduct an examination of the contracts between AT&T and South Central Bell for the use of multifunction plant to determine their reasonableness and the extent to which the divestiture order affects the freedom of the Commission to adjust these expenses for regulatory purposes.

Fifth, South Central Bell will from time to time be required to construct projects to serve the needs of interexchange customers. Procedures must be developed to permit regulatory scrutiny of these projects and the compensation received from AT&T and other carriers. The staff should analyze these issues in the continuing proceeding.

IV. CONCLUSION

For the foregoing reasons,

IT IS ORDERED that South Central Bell Telephone Company will be permitted to raise its intrastate rates in

the gross amount of $126,393,000. After the implementation of the increase, $62.7 million of the revenues of South Central Bell will be subject to refund. In addition, these proceedings shall remain open to formulate recommendations regarding the other issues described in this Order. The Company is also ordered to expend at least $300 million on construction, to improve and upgrade service, in the 12 months beginning September 1, 1984.

BY ORDER OF THE COMMISSION:
BATON ROUGE, LOUISIANA
OCTOBER 1, 1984

/s/ Signed
CHAIRMAN

/s/ Signed
John Schwegmann concurs in part and dissents in part.*
VICE CHAIRMAN

/s/ Ed Kennon dissents.
COMMISSIONER

/s/ Signed
COMMISSIONER

/s/ Signed
COMMISSIONER

/s/ Signed
SECRETARY

* Commissioner Schwegmann concurs in all parts of this Order except the decision to approve an additional $21.72 million in depreciation expense for 1984 represcriptions approved by the FCC. Commissioner Schwegmann would approve this additional expense only if it were mandated by the courts. Commissioner Schwegmann would approve a rate increase of $104,673,000.

* Commissioner Lambert concurs in all parts of this Order except the decision to approve an additional $21.72 million in depreciation expense for 1984 represcriptions mandated by the FCC. Commissioner Lambert would deny the depreciation expense. However, Commissioner Lambert agrees that a rate increase of $126,393,000 is necessary to ensure the financial viability of the telephone company and permit it to make necessary capital expenditures. Therefore, Commissioner Lambert joins Commissioners Ackel and Powell in approving a rate increase of $126,393,000.

APPENDIX "E"
STATUTES INVOLVED

47 U.S.C. §151:

For the purpose of regulating interstate and foreign commerce in communication by wire and radio so as to make available, so far as possible, to all the people of the United States a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges, for the purpose of the national defense, for the purpose of promoting safety of life and property through the use of wire and radio communication, and for the purpose of securing a more effective execution of this policy by centralizing authority heretofore granted by law to several agencies and by granting additional authority with respect to interstate and foreign commerce in wire and radio communication, there is created a commission to be known as the "Federal Communications Commission", which shall be constituted as hereinafter provided, and which shall execute and enforce the provisions of this chapter.

47 U.S.C. §152:

(a) The provisions of this chapter shall apply to all interstate and foreign communication by wire or radio and all interstate and foreign transmission of energy by radio, which originates and/or is received within the United States, and to all persons engaged within the United States in such communication or such transmission of energy by radio, and to the licensing and regulating of all radio stations as hereinafter provided; but it shall not apply to persons engaged in wire or radio communication or transmission in the Canal Zone, or to wire or radio communication or transmission wholly within the Canal Zone.

(b) Except as provided in section 224 of this title and subject to the provisions of section 301 of this title, nothing in this chapter shall be construed to apply or to give the Comission jurisdiction with respect to (1) charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service by wire or radio of any carrier, or (2) any carrier engaged in interstate or foreign communication solely through physical connection with the facilities of another carrier not directly or indirectly controlling or controlled by, or under direct or indirect common control with such carrier, or (3) any carrier engaged in interstate or foreign communication solely through connection by radio, or by wire and radio, with facilities, located in an adjoining State or in Canada or Mexico (where they adjoin the State in which the carrier is doing business), of another carrier not directly or indirectly controlling or controlled by, or under direct or indirect common control with such carrier, or (4) any carraier to which clause (2) or clause (3) of this subsection would be applicable except for furnishing interstate mobile radio communication service or radio communication service to mobile stations on land vehicles in Canada or Mexico; except that sections 201 to 205 of this title shall, except as otherwise provided therein, apply to carriers described in clauses (2), (3), and (4) of this subsection.

47 U.S.C. §153(e)

(e) "Interstate communication" or "interstate transmission" means communication or transmission (1) from any State, Territory, or possession of the United States (other than the Canal Zone), or the District of Columbia, to any other State, Territory, or possession of tahe United States (other than the Canal Zone), or the District of Columbia, (2) from or to the United States to or from the

Canal Zone, insofar as such communication or transmission takes place within the United States, or (3) between points within the United States but through a foreign country; but shall not, with respect to the provisions of subchapter II of this chapter (other than section 223 of this title), include wire or radio communication between points in the same State, Territory, or possession of the United States, or the District of Columbia, through any place outside thereof, if such communication is regulated by a State commission.

47 U.S.C. §220:

(a) The Commission may, in its discretion, prescribe the forms of any and all accounts, records, and memoranda to be kept by carriers subject to this chapter, including the accounts, records, and memoranda of the movement of traffic, as well as of the receipts and expenditures of moneys.

(b) The Commission shall, as soon as practicable, prescribe for such carriers the classes of property for which depreciation charges may be properly included under operating expenses, and the percentages of depreciation which shall be charged with respect to each of such classes of property, classifying the carriers as it may deem proper for this purpose. The Commission may, when it deems necessary, modify the classes and percentages as prescribed. Such carriers shall not, after the Commission has prescribed the clasess[1] of property for which depreciation charges may be included, charge to operating expenses any

depreciation charges on classes of property other than those prescribed by the Commission, or, after the Commission has prescribed percentages of depreciation, charge with respect to any class of property a percentage of depreciation other than that prescribed therefor by the Commission. No such carrier shall in any case include in any form under its operating or other expenses any depreciation or other charge or expenditure included elsewhere as a depreciation charge or otherwise under its operating or other expenses.

(c) The Commission shall at all times have access to and the right of inspection and examination of all accounts, records, and memoranda, including all documents, papers, and correspondence now or hereafter existing, and kept or required to be kept by such carriers, and the provisions of this section respecting the preservation and destruction of books, papers, and documents shall apply thereto. The burden of proof to justify every accounting entry questioned by the Commission shall be on the person making, authorizing, or requiring such entry and the Commission may suspend a charge or credit pending submission of proof by such person. Any provision of law prohibiting the disclosure of the contents of messages or communications shall not be deemed to prohibit the disclosure of any matter in accordance with the provisions of this section.

(d) In case of failure or refusal on the part of any such carrier to keep such accounts, records, and memoranda on the books and in the manner prescribed by the Commission, or to submit such accounts, records, memoranda, documents, papers, and correspondence as are kept to the inspection of the Commission or any of its authorized agents, such carrier shall forfeit to the United States the sum of $500 for each day of the continuance of each such offense.

(e) Any person who shall willfully make any false entry in the accounts of any book of accounts or in any record or memoranda kept by any such carrier, or who shall willfully destroy, mutilate, alter, or by any other means or device falsify any such account, record, or memoranda, or who shall willfully neglect or fail to make full, true, and correct entries in such accounts, records, or memoranda of all facts and transactions appertaining to the business of the carrier, shall be deemed guilty of a misdemeanor, and shall be subject, upon conviction, to a fine of not less than $1,000 nor more than $5,000 or imprisonment for a term of not less than one year nor more than three years, or both such fine and imprisonment: *Provided*, That the Commission may in its discretion issue orders specifying such operating, accounting, or financial papers, records, books, blanks, or documents which may, after a reasonable time, be destroyed, and prescribing the length of time such books, papers, or documents shall be preserved.

(f) No member, officer, or employee of the Commission shall divulge any fact or information which may come to his knowledge during the course of examination of books or other accounts, as hereinbefore provided, except insofar as he may be directed by the Commission or by a court.

(g) After the Commission has prescribed the forms and manner of keeping of accounts, records, and memoranda to be kept by any person as herein provided, it shall be unlawful for such person to keep any other accounts, records, or memoranda than those so prescribed or such as may be approved by the Commission or to keep the accounts in any other manner than that prescribed or approved by the Commission. Notice of alterations by the Commission in the required manner or form of keeping accounts

shall be given to such persons by the Commission at least six months before the same are to take effect.

(h) The Commission may classify carriers subject to this chapter and prescribe different requirements under this section for different classes of carriers, and may, if it deems such action consistent with the public interest, except the carriers of any particular class or classes in any State from any of the requirements under this section in cases where such carriers are subject to State commission regulation with respect to matters to which this section relates.

(i) The Commission, before prescribing any requirements as to accounts, records, or memoranda, shall notify each State commission having jurisdiction with respect to any carrier involved, and shall give reasonable opportunity to each such commission to present its views, and shall receive and consider such views and recommendations.

(j) The Commission shall investigate and report to Congress as to the need for legislation to define further or harmonize the powers of the Commission and of State commissions with respect to matters to which this section relates.

47 U.S.C. §221(b); (c):

(b) Subject to the provisions of section 301 of this title, nothing in this chapter shall be construed to apply, or to give the Commission jurisdiction, with respect to charges, classifications, practices, services, facilities, or regulations for or in connection with wire, mobile, or point-to-point radio telephone exchange service, or any combi-

nation thereof, even though a portion of such exchange service constitutes interstate or foreign communication, in any case where such matters are subject to regulation by a State commission or by local governmental authority.

(c) For the purpose of administering this chapter as to carriers engaged in wire telephone communication, the Commission may classify the property of any such carrier used for wire telephone communication, and determine what property of said carrier shall be considered as used in interstate or foreign telephone toll service. Such classification shall be made after hearing, upon notice to the carrier, the State commission (or the Governor, if the State has no State commission) of any State in which the property of said carrier is located, and such other persons as the Commission may prescribe.

47 U.S.C. §410:

(a) Except as provided in section 409 of this title, the Commission may refer any matter arising in the administration of this chapter to a joint board to be composed of a member, or of an equal number of members, as determined by the Commission, from each of the States in which the wire or radio communication affected by or involved in the proceeding takes place or is proposed. For purposes of acting upon such matter any such board shall have all the jurisdiction and powers conferred by law upon an examiner provided for in section 3105 of Title 5, designated by the Commission, and shall be subject to the same duties and obligations. The action of a joint board shall have such force and effect and its proceedings shall be conducted in such manner as the Commission shall by regulations prescribe. The joint board member or members for each State shall be nominated by the State commission of the

State or by the Governor is there is no State commission, and appointed by the Federal Communications Commission. The Commission shall have discretion to reject any nominee. Joint board members shall receive such allowances for expenses as the Commission shall provide.

(b) The Commission may confer with any State commission having regulatory jurisdiction with respect to carriers, regarding the relationship between rate structures, accounts, charges, practices, classifications, and regulations of carraiers subject to the jurisdiction of such State commission and of the Commission; and the Commission is authorized under such rules and regulations as it shall prescribe to hold joint hearings with any State commission in connection with any matter with respect to which the Commission is authorized to act. The Commission is authorized in the administration of this chapter to avail itself of such cooperation, services, records, and facilities as may be afforded by any State commission.

(c) The Commission shall refer any proceeding regarding the jurisdictional separation of common carrier property and expenses between interstate and intrastate operations, which it institutes pursuant to a notice of proposed rulemaking and, except as provided in section 409 of this title, may refer any other matter, relating to common carrier communications of joint Federal-State concern, to a Federal-State Joint Board. The Joint Board shall possess the same jurisdiction, powers, duties, and obligations as a joint board established under subsection (a) of this section, and shall prepare a recommended decision for prompt review and action by the Commission. In addition, the State members of the Joint Board shall sit with the Commission en banc at any oral argument that may be scheduled in the proceeding. The Commission shall also afford the

State members of the Joint Board an opportunity to participate in its deliberations, but not vote, when it has under consideration the recommended decision of the Joint Board or any further decisional action that may be required in the proceeding. The Joint Board shall be composed of three Commissioners of the Commission and of four State commissioners nominated by the national organization of the State commissions as referred to in sections 302(b) and 305(f) of Title 49, and approved by the Commission. The Chairman of the Commission, or another Commissioner designated by the Commission, shall serve as Chairman of the Joint Board.